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A T T O R N E Y S

November 13, 2001

Honorable David P. Boergers
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

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RE: Avista Corporation; The Montana Power Company; Nevada Power Company; Portland General Electric Company; and Sierra Pacific Power Company; TransConnect, LLC

Docket Nos. RT01-15-____ and ER02-_____

Dear Secretary Boergers:

Pursuant to Section 205 of the Federal Power Act, 16 U.S.C. § 824d (1994), Part 35 of the Commission's regulations, 18 C.F.R. Part 35 (2001), and the Commission's April 26, 2001 order in Docket Nos. RT01-15-000 and RT01-35-000, 95 FERC ¶ 61,114 (2001), the above captioned applicants, comprising TransConnect, LLC, hereby tender for filing fourteen (14) copies of the "Application of TransConnect, LLC For Preliminary Approval of Transmission Rates, Including Innovative Transmission Rate Treatment; Planning and Expansion Protocol; Compliance Filing; and Modified Governance Proposal." Avista Corporation and The Montana Power Company are joining only the planning protocol, compliance filing, and modified governance sections of the filing; they are not joining in the rate filing.

Attached hereto is a form of notice suitable for publication in the *Federal Register* and a computer diskette containing the notice in WordPerfect format. Because of the size of this filing, only the filing letter is being served on the customers and parties identified in Appendix B of the Application. The complete filing will be provided electronically or in hard copy upon request, and is also available at the TransConnect section of the RTO West web site at www.rtowest.org.

If you have any questions, or if I may be of further assistance, please do not hesitate to contact me at (202) 912-2153.

Very truly yours,

Paul B. Mohler
Counsel for TransConnect, LLC

Attachments

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

| | | |
|---|---|---------------------------------|
| Avista Corporation;¹ |) | |
| The Montana Power Company;¹ |) | |
| Nevada Power Company; |) | Docket No. RT01-15-_____ |
| Portland General Electric Company; |) | |
| and |) | Docket No. ER02-_____ |
| Sierra Pacific Power Company |) | |
| |) | (Not Consolidated) |
| TransConnect, LLC |) | |

**Application of TransConnect, LLC For Preliminary Approval of
Transmission Rates, Including Innovative Transmission Rate Treatment;
Planning and Expansion Protocol; Compliance Filing;
and Modified Governance Proposal**

Dated: November 13, 2001

¹ Avista Corporation and The Montana Power Company are joining in only the planning protocol, modified governance, and compliance filing sections of the filing.

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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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| Avista Corporation; |) | |
| The Montana Power Company; |) | |
| Nevada Power Company; |) | Docket No. RT01-15-___ |
| Portland General Electric Company; |) | |
| and |) | Docket No. ER02-_____ |
| Sierra Pacific Power Company |) | |
| |) | (Not Consolidated) |
| TransConnect, LLC |) | |

**Application of TransConnect, LLC For Approval of Transmission
Rates, Including Innovative Transmission Rate Treatment;
Planning and Expansion Protocol; Compliance Filing;
and Modified Governance Proposal**

I. Introduction and Background

Pursuant to Section 205 of the Federal Power Act (“FPA”) and Part 35 of the Commission’s regulations, the above captioned parties (collectively the “Applicants”) and TransConnect, LLC (“TransConnect”) hereby tender for filing fourteen (14) copies of the instant application (“Application”) with the Federal Energy Regulatory Commission (“Commission”). Specifically, the Application requests preliminary approval of transmission rates that reflect the underlying transmission assets that will be transferred to TransConnect

by the Applicants,² subject to additional approvals that must still be obtained. These rates reflect innovative and incentive features consistent with Section 35.34(e) of the Commission's regulations and the Commission's requirements under Order No. 2000.³

In addition, TransConnect (1) seeks Commission approval to undertake a planning and expansion function, as proposed herein; (2) submits a compliance filing in accord with the Commission April 26, 2001 order in Docket Nos. RT01-15-000 and RT01-35-000 ("April 26 Order");⁴ and (3) proposes to revise its governance to enable TransConnect to offer additional membership flexibility.

In order to permit the Applicants to make necessary decisions in a timely and informed way, and to provide for an organized business formation process, the Applicants respectfully request the Commission to act on this filing no later than January 30, 2002.

A. Executive Summary

As an independent transmission company ("ITC"), TransConnect will be a single-purpose company with clear and rational economic incentives to plan for and make justified and necessary expansions to the transmission grid, and to operate existing transmission assets in a reliable and cost-effective manner. TransConnect will operate transmission facilities

² Avista Corporation and The Montana Power Company are not joining in the rate application section of the filing; they are joining in the remaining sections of the filing.

³ *Regional Transmission Organizations*, Order No. 2000, 65 Fed. Reg. 809 (January 6, 2000), FERC Stats. & Regs. ¶ 31,089 (1999), *order on reh'g*, Order No. 2000-A, 65 Fed. Reg. 12088 (March 8, 2000), FERC Stats. & Regs. ¶ 31,092 (2000), *review pending sub nom.*, *Public Utility Dst. No. 1 of Snohomish Cty., WA v. FERC*, Nos. 00-1174, *et al.* (D.C. Cir.)

⁴ *Avista Corporation, et al.*, 95 FERC ¶ 61,114 (2001), *order on reh'g* 96 FERC ¶ 61,058 (2001).

currently owned and operated by the TransConnect Applicants (as well as other transmission entities that may join TransConnect in the future).⁵ Puget Sound Energy, Inc., formerly an applicant and prospective member of TransConnect, has withdrawn from this endeavor.⁶ Avista Corporation and The Montana Power Company are not participating in the rate filing section of this filing.

TransConnect proposes to establish rates for “zones” that match the territories served by each of the applicant utilities. Although TransConnect is seeking rate authority for only three zones at this time, TransConnect will file for other applicable zones when it makes its final implementation filing. Innovative and incentive rate treatments are proposed to encourage investment in new transmission and efficient, reliable, and cost-effective operation of TransConnect’s transmission assets.

⁵ As noted in the October 16 Filing, these applicants reserve the right to reconsider the instant proposal and the manner of their participation in RTO West (or some other regional transmission organization (“RTO”)) should the Commission modify or reject the proposals contained herein, or due to any economic, operational or commercial reasons that may become apparent as the ITC and RTO developmental process unfolds. Many of the necessary documents and regulatory approvals have not yet been obtained. Ultimately, whether or not to join TransConnect will be a business decision that must be made by the management of each company based on its individual economic and business evaluation of the ITC proposal in its entirety. This reservation of a final decision by the managements of the Applicants to transfer nearly \$1 billion in assets is prudent and reasonable in these circumstances. It is not intended to diminish the importance of the instant filing, or the need for prompt Commission action that will permit a comprehensive economic evaluation and business decision regarding the ITC proposal before the implementation date.

⁶ Notice of Puget Sound Energy, Inc.’s withdrawal was provided to the Commission by letter dated August 17, 2001.

TransConnect proposes to share the planning and expansion functions with each RTO within which it operates. The RTO will have ultimate authority over projects affecting the reliability of the RTO's transmission system. TransConnect will have the right to plan and propose transmission projects; for projects not adversely affecting reliability or transfer capability, the RTO will not unreasonably delay or withhold approval. Included with this filing is a *pro forma* Planning and Expansion Protocol that TransConnect proposes to use as the model for establishing a final protocol with each of the RTOs (if more than one) within which TransConnect operates.

In compliance with the Commission's guidance in the April 26 Order, TransConnect is providing revised governance documents that address the Commission's concerns with regard to Class C shares and the filing of audit reports.

Finally, TransConnect is proposing to modify its governance documents to provide greater flexibility for transmission entities that do not wish to divest assets to participate in TransConnect. Instead of transferring legal title, such entities would grant functional control over their transmission assets to TransConnect. TransConnect would then manage these assets and would include any such assets in the applicable RTO operating or control agreement. TransConnect is also proposing to modify its governance documents to permit the participation and investment by public power entities. As before, TransConnect would be independent of market participants, including those members who transfer functional control over, but do not divest, transmission assets to TransConnect.

B. Procedural History

On October 16, 2000, six public utilities -- Avista Corporation, The Montana Power Company, Nevada Power Company, Portland General Electric Company, Puget Sound Energy, Inc., and Sierra Pacific Power Company -- filed an “Order No. 2000 Compliance Filing and Request for Declaratory Order” that proposed to form an ITC that would own and operate the transmission portions of their respective systems (“October 16 Filing”).⁷ The October 16 Filing requested the Commission to find that (1) TransConnect will meet or exceed the minimum requirements for independence and (2) the functions that TransConnect proposes to undertake – related to rate filings and transmission planning and expansion – are acceptable.

On October 16 and 23, 2000, a group of utilities comprising the Applicants plus Bonneville Power Administration, PacificCorp, Puget Sound Energy, Inc, and Idaho Power Company filed an Order No. 2000 compliance filing and request for declaratory order proposing to form RTO West. As proposed, RTO West would be a not-for-profit regional transmission organization that would operate transmission systems in the Western United States.

On April 26, 2001, the Commission issued an order addressing the TransConnect and RTO West filings. 95 FERC ¶ 61,114 (2001). The April 26 Order largely approved the TransConnect proposal, subject to: (a) clarification and a notice requirement related to Class

⁷ As noted above, Puget Sound Energy, Inc. has withdrawn from the TransConnect application.

C Common Stock; and (b) a requirement that audit reports of the TransConnect independent compliance auditor be publicly filed with the Commission within 60 days of completion of the audit. In addressing TransConnect's proposal to file for innovative rates, the order stated the Commission would evaluate each pricing proposal by an ITC "on a case-by-case basis to ensure it will operate appropriately in the particular RTO circumstances." 95 FERC at 61,339.

The April 26 Order also provided that the planning and expansion function could be shared between TransConnect and RTO West, but required additional detail and clarity be provided in TransConnect's and RTO West's Stage 2 filings. *Id.* at 61,341. On July 12, 2001, the Commission denied rehearing of the issues related to TransConnect. 96 FERC ¶ 61,058 (2001).

TransConnect has also recently engaged in discussions with WestConnect RTO, LLC, an RTO that shares with TransConnect the vision for a for-profit transmission company. While these discussions are still at a preliminary stage, TransConnect is hopeful they will create additional opportunities for combining efforts to create a broad-based RTO in the West.

C. Description of Applicant

1. TransConnect

TransConnect will be the FERC jurisdictional portion of a proposed ITC consisting of two interrelated entities: TransConnect and TransConnect Corporate Manager, Inc. TransConnect will be owned by "Members" who have contributed assets or made cash capital contributions to TransConnect. TransConnect Corporate Manager, Inc. will serve as the

“Managing Member” of TransConnect. TransConnect Corporate Manager, Inc. will initially hold a nominal financial membership interest in TransConnect. TransConnect and TransConnect Corporate Manager, Inc. are structured to be fully independent of any market participant, including their predecessor, transmission-owning, vertically-integrated utilities. TransConnect Corporate Manager, Inc. will be governed by an independent, highly qualified Board of Directors. The governance documents provide that, in performing their fiduciary duties, neither the Managing Member or the Board of Directors shall consider the interests that the Members of TransConnect may have as participants in the electric market served by TransConnect. TransConnect and TransConnect Corporate Manager, Inc. will be incorporated in the State of Delaware. Each of the TransConnect Applicants are briefly described below.

Further, pursuant to the modified LLC Operating Agreement, entities that choose not to contribute assets or make cash capital contributions, or that are prevented from owning an equity interest in a for-profit entity, may become "Participants" of TransConnect by granting "Functional Control" over their transmission assets pursuant to a Transmission Management Agreement. The modified LLC Operating Agreement also gives such Participants the option to participate in certain capital calls and make other investments in TransConnect.

2. Avista Corporation

Avista Corporation is a corporation created and organized under the laws of the State of Washington with its principal office in Spokane, Washington. Avista is an investor-owned, natural gas and electric utility engaged in, among other things, the businesses of: (1)

distributing natural gas for residential, commercial and industrial use; and (2) generating, transmitting and distributing electric power to wholesale and retail customers and transmitting electric power on behalf of third parties.

3. The Montana Power Company

The Montana Power Company is currently an investor-owned utility that provides electric and natural gas transmission and distribution services and electric and natural gas supply service to customers that have not chosen third party suppliers within the state of Montana.

4. Nevada Power Company

Nevada Power Company is an electric utility with its principal place of business in Las Vegas, Nevada. Nevada Power Company serves customers at retail and wholesale in Southern Nevada and is a wholly-owned subsidiary of Sierra Pacific Resources, a Nevada corporation.

5. Portland General Electric Company

Portland General Electric Company is currently an operating electric utility subsidiary of Enron Corporation.⁸ Portland General Electric Company provides wholesale and retail electric service to customers in Salem and Portland, Oregon, and surrounding areas, and has

⁸ On October 8, 2001, Enron Corporation announced that it had entered into an agreement to sell Portland General Electric Company to Northwest Natural Gas Company. The announcement stated that the proposed transaction, which is subject to customary regulatory approvals, is expected to close by the fourth quarter of 2002.

authority to make wholesale power sales to third parties. It also provides wholesale transmission services.

6. Sierra Pacific Power Company

Sierra Pacific Power Company is currently an electric public utility providing retail service to customers in the states of Nevada and California, and wholesale transmission service. Sierra Pacific Power Company is also a gas public utility providing service to customers in Northern Nevada and the Lake Tahoe area of California. Sierra Pacific Power Company is incorporated pursuant to the laws of the state of Nevada and is a wholly-owned subsidiary of Sierra Pacific Resources, a Nevada corporation.

D. Collaborative Process

TransConnect has sought to use an open and collaborative process as encouraged by the Commission to develop key aspects of this filing. On August 2, 2001, TransConnect posted a summary of its proposed rate filing on the RTO West web site and presented and discussed it at an August 24, 2001 meeting of the RTO West regional representatives group (“RRG”). On August 31, 2001, TransConnect posted a draft Planning and Expansion Protocol and solicited comments. On October 3, 2001, and again on October 26, 2001, TransConnect posted revised draft *Pro Forma* Planning and Expansion Protocols. The revised planning proposals were addressed at various RTO West RRG, planning content group, and caucus meetings. As a result of this process, a number of modifications were made to the rate filing and to the *Pro Forma* Planning and Expansion Protocol.

E. The TransConnect Business Model

TransConnect's business model is well suited to developing the transmission infrastructure necessary to foster a competitive market for electric energy. Because it is not a market participant, and because it is a for-profit transmission provider, TransConnect will have incentives to propose and build new transmission, upgrade existing transmission, or undertake other transmission ventures or cost-saving measures that otherwise may not be considered. A key component to the success of this model is the set of innovative and performance-based rates that are proposed in this Application.

It is also critical that TransConnect retain as much control as possible over the operation of its newly acquired facilities, and the planning and expansion of future facilities. The reason is simple: as a for-profit enterprise, TransConnect will have incentives to find new and creative ways to transport electricity more efficiently across the existing system, as well as to efficiently construct new transmission that is needed and would be economic. If the not-for-profit RTO micro-manages the operation of TransConnect's facilities or monopolizes the planning and expansion function, much of this potential for creative solutions will be lost, just as it has been lost under the current cost-of-service regulatory regimes. This same concept was recognized by the Commission in the April 26 Order when it stated that, "[w]e believe it is appropriate to propose mechanisms that will provide incentives for the TransConnect members to take actions within their control to improve grid operations." *Id.* at 61,338. TransConnect will have a customer orientation that not-for-profit,

quasi-governmental, or vertically integrated utilities may lack. The benefits of the ITC model have also been recognized and described in detail by leading industry analysts and scholars.⁹

II. TransConnect Rate Proposal

A. Effective Date and Request for Preliminary Approval

TransConnect seeks preliminary approval of its innovative and incentive rate proposals and, following such preliminary approval, proposes that it make a compliance filing at least 60 days prior to the actual effective date. Such compliance filing would incorporate any modifications required by the Commission, together with approved rate adjustments. This approach is similar to the preliminary approval process that has been used by the Commission in natural gas pipeline certificate proceedings. As explained by the Commission in that context, preliminary approval permits business to be conducted with greater certainty regarding the outcome of the regulatory process. *See, e.g., Pricing Policy for New and Existing Facilities Constructed by Interstate Natural Gas Pipelines*, 71 FERC ¶ 61,241 at 61,918 (1995). Similarly here, the additional certainty that can be gained by early Commission action on the proposed rate treatments will permit the applicants to effectively plan and implement the transition to an ITC.

The actual date on which TransConnect will become effective is uncertain at this time. TransConnect was intended to become effective contemporaneously with the effectiveness of

⁹ *See, e.g., Unlocking the Benefits of Restructuring: A Blueprint for Transmission*, Awerbuch, Hyman and Vesey, Public Utility Reports Inc., 1999; *The Future of Electric Transmission in the United States, A Vision for Transmission as a Vibrant, Stand-Alone, For-Profit Business*, Gale, Graves, and Clapp, PA Consulting Group, 2001.

RTO West. TransConnect may seek to effectuate the ITC prior to the effectiveness of RTO West, if it receives the regulatory and board approvals that are necessary to launch the new company, and it determines that such early effectiveness would be a sound business decision. Permitting an ITC to become effective prior to the effectiveness of an RTO that it commits to join would be consistent with the Commission's ruling in *Independent Transmission Company*, 92 FERC ¶ 61,276 (2000).

TransConnect requests the Commission not set this Application for hearing. Many of the elements of the Application raise issues of Commission policy that do not require the intensive fact finding of a fully litigated proceeding. To the extent the Commission determines a hearing is necessary, TransConnect requests it be limited to only specific issues that the Commission enumerates, rather than the entire Application. Alternatively, and particularly given the longer than usual advance notice provided by this filing, the Commission may wish to utilize paper hearing or technical conference procedures to narrow and potentially resolve any questions or outstanding issues prior to determining what remaining issues, if any, require a formal evidentiary hearing.

B. Zone Rates

Because TransConnect comprises non-contiguous transmission, and because of RTO West's license plate rate design, TransConnect proposes costs of service and rates for each of the zones that would otherwise be served by the company from whom transmission assets were received. The initial rates proposed in this filing reflect traditional cost-of-service ratemaking elements, as previously approved by the Commission. Thus, for example, rates for the Portland General zone reflect the twelve monthly coincident peak ("12 CP")

methodology previously used and approved for Portland General, while the rates for Nevada Power zone reflect the 4 CP methodology previously used and approved for Nevada Power. Use of these previously approved methods ensures that rates will appropriately reflect known differences in the loads served in each zone. The initial representative rates that result from this traditional process will be the starting point for the incentive elements described below.¹⁰

C. Innovative and Performance-Based Rate Treatments

The innovative and performance-based rate treatments proposed by TransConnect are supported in the testimony of David B. Patton (Exhibit TC-4). TransConnect proposes three ratemaking innovations described in Order No. 2000. First, the rates are designed as a rate cap, with a portion of the rate subject to an indexed adjustment annually. Second, TransConnect proposes to develop over its initial year of operation a proposal to establish performance benchmarks. Third, the rates include incentive pricing provisions designed to encourage efficient investment in transmission facilities, including a higher return on equity for certain new transmission investments.

1. The Rate Cap Proposal and Sharing Mechanisms

The proposed rate cap would lock rates in place for a 5-year period, subject only to limited adjustments agreed upon in advance. The exceptions relate to an adjustment factor for Operation and Maintenance costs (“O&M”), a sharing mechanism for Administrative and

¹⁰ The proposed rates do include recovery of costs associated with the provision of ancillary or other services that TransConnect may be obliged to undertake as a member of an RTO. To the extent TransConnect is required to provide such services (which it would likely have to procure through the market), TransConnect reserves the right to file for an appropriate cost recovery or flow-through mechanism.

General costs (“A&G”), and for filing for certain types of new investment. By fixing rates for an extended period, TransConnect bears the risk of under recovering costs if it cannot achieve cost savings during that period; it also has an incentive to achieve such cost savings because it would be permitted to share with customers the savings that it is able to achieve.

The proposed O&M index is modeled after a form of rate cap structure commonly referred to an “RPI-X” structure, where “RPI” is a price index and the “X” is a productivity adjustment. TransConnect proposes to use the Consumer Price Index (“CPI”) as the index and 0.5 percent as the productivity adjustment. This index would then be applied annually to the O&M portion of the revenue requirement. O&M costs typically change with changes in general price levels, but also, to some extent, are within the control of the transmission owner. As detailed in Dr. Patton’s testimony, the CPI is a reasonable index to use as it has generally tracked or grown somewhat more slowly than the historical growth of electric utility O&M costs. Its use here thus will provide another potential benefit to consumers, and an incentive to TransConnect to manage and control costs. The 0.5 percent productivity adjustment will provide an additional sharing of cost savings with TransConnect’s transmission customers, and an additional incentive for TransConnect to manage and control costs.

Another element of the incentive rate design is a sharing mechanism for A&G costs. Although TransConnect expects to achieve savings in A&G costs, the precise level of these savings is difficult to measure *ex ante*. Therefore, TransConnect proposes to initially include A&G based on the traditional base and test year measures, but to annually adjust A&G to the

prior year's actual A&G costs, with a fifty-fifty sharing of any savings, and with TransConnect fully at risk for any increases from the initially established A&G level. This mechanism will give TransConnect an incentive to reduce A&G since it would retain one-half the reductions below the initial A&G level, while benefiting its customers through a direct and timely sharing of such cost reductions, and a fixed upper limit on A&G costs.

TransConnect does not propose to include any start up costs in its initial rates. This will provide an additional significant benefit to consumers upon the effectiveness of the TransConnect rates, and will provide an incentive for TransConnect to minimize its start up costs.

TransConnect proposes that the rate cap remain in place for five years from the effective date of TransConnect's rates. This period will ensure that TransConnect has the time and incentive to reduce costs over the long term. To ensure there is not a disincentive to reduce costs in the later part of the rate cap period, TransConnect proposes that it be permitted to retain 50 percent of the savings it achieves during the rate cap period.

2. Benchmarks

TransConnect proposes to implement benchmarks after gaining experience operating its combined transmission system. TransConnect anticipates that a benchmark proposal will be developed through a collaborative process with the RTOs within which it operates and TransConnect's transmission customers. Designing appropriate benchmarks and establishing efficient incentives and penalty levels are important to ensure that the proposal will not distort the behavior of the transmission owner or operator by providing incentives that are either too

strong or too weak relative to the price cap incentives. Dr. Patton's testimony further discusses this concept.

3. Incentives Related to New Transmission

Dr. Patton proposes the following alternative recovery mechanisms for new transmission investments:

- Transmission investments made in response to requests for service by a transmission customer would be directly assigned to the customer and recovered through either a lump-sum payment or through an incremental charge to the customer. In return, the customer would receive the transmission service or Firm Transmission Rights made available by the new investment.
- Likewise, the Applicants may choose to make investments, consistent with the planning and expansion protocol, that are justified primarily by the economic value of the new capability created by the investment. These investment costs would be borne by the Applicants (i.e., directly assigned), and the Applicants would receive the Firm Transmission Rights associated with the new capability.
- Both Transmission Customers and the Applicants would have the right to assert that a portion of a directly assigned transmission investment provides system-wide benefits that justify allocating part of the costs to all customers in the zone. Preliminary determinations on this type of allocation would be made by the RTO.
- To the extent that new transmission investments provide system-wide benefits or are made pursuant to RTO and TransConnect planning processes, the capital costs would be recovered from all customers in the

zone. However, in light of the rate cap, the Applicants will be unable to earn a return on any investments that cause net plant to increase. Hence, to avoid investment disincentives while maintaining the rate cap, the Applicants will retain the right to file for an incremental rate that allows recovery of this incremental net plant. Furthermore, to ensure adequate incentives and availability of capital to invest in these facilities, all charges associated with the new investments would be depreciated over 15 years and the return on equity would be adjusted by 200 basis points to provide adequate incentive to expand the transmission system.

These alternative recovery mechanisms will provide TransConnect with the flexibility necessary to fund a variety of different types of expansion projects and are consistent with the Commission's goal to encourage the development of needed infrastructure in the Western United States.

D. Return on Equity

As discussed in the testimony of William E. Avera (Exhibit TC-10), TransConnect presents several unique problems in evaluating an appropriate level of return. First, it is a startup company with no traded stock or bonds.¹¹ Second, there are no publicly traded “pure play” electric transmission companies to use as benchmarks in evaluating investors' risk

¹¹ The Commission has recently permitted returns on equity of 14 percent for initial rates for gas pipeline companies that do not face the same level of risk that TransConnect will face. *See, e.g., Buccaneer Gas Pipeline Co.*, 91 FERC ¶ 61,117 at 61,446 (2000) (approving ROE of 14 percent); *Gulfstream Natural Gas System, L.L.C.*, 91 FERC ¶ 61,119 at 61,463 (2000) (same); *Guardian Pipeline, L.L.C.*, 91 FERC ¶ 61,285 at 61,982 (2000) (same); *Questar Southern Trails Pipeline Co.*, 89 FERC ¶ 61,050 at 61,147 (1999) (same). After the start up, TransConnect may issue stock, or members' interests may be converted to stock that could be publicly traded.

assessments and estimating their required returns. Third, TransConnect will have a small capitalization relative to other electric utilities and will undertake a major capital spending program relative to its size. In short, TransConnect will be a newly formed company with no track record entering a restructured industry without established business practices.

TransConnect will seek to maintain a debt/equity ratio of 50 percent debt to 50 percent equity. Mr. Avera concludes that, based on his analysis, TransConnect should be authorized a rate of return on equity (“ROE”) in a range between 12.0 and 15.5 percent.

The testimony of Carolyn Cowan (Exhibit TC-16) further addresses the risks faced by transmission companies active in planning and expanding the transmission grid. Ms. Cowan concludes that, in the circumstances of this case, and in order to ensure investor confidence and attract capital investment in transmission facilities, an initial ROE for TransConnect should be set in the upper area of this range. Ms. Cowan, therefore, recommends a ROE of 14.5 percent.

Mr. Avera’s recommended range is not dependent on the higher returns the Commission suggested might be obtained under the Commission’s innovative rate policy. Instead, utilizing a fully developed financial analysis, Mr. Avera has concluded that the unique circumstances faced by TransConnect alone justify his recommended range of reasonableness for setting the return on equity. Although Mr. Avera’s recommendation is consistent with the Commission’s discussion of the risks encountered by “a stand-alone

transco facing a significant expansion program,”¹² the risk profile and other financial circumstances surrounding the formation and initial operation of TransConnect independently justify the requested return.

E. Tariff

Exhibit TC-3 reflects illustrative rates that TransConnect expects to incorporate into an RTO tariff. TransConnect anticipates that an RTO tariff will appropriately accommodate the relationship between an ITC and an RTO, and that a separate TransConnect tariff should not be required.¹³ Should a separate TransConnect tariff be required, either because of the structure of the RTO tariff, or by Commission direction, TransConnect will prepare and file a separate tariff as part of its compliance filing.

In the event that TransConnect seeks to become operational and make its rates effective prior to the commencement of operations by RTO West, or other applicable RTO, TransConnect will separately submit a tariff to bridge the period until the applicable RTO tariff becomes operational.

¹² Order No. 2000 at 31,192-93.

¹³ *See, e.g.*, 95 FERC at 61,339.

F. Compliance with the Order No. 2000 Requirements for Innovative Rate Treatment

1. TransConnect Meets the Requirements to File for Innovative Rate Treatment.

The Commission determined in the April 26 Order that “it is appropriate to allow a transmission entity that is independent of market participants to include a request for innovative rate treatments”¹⁴ As an independent transmission company, TransConnect qualifies to file for innovative rates.

2. TransConnect’s Proposed Rates Will Be Just and Reasonable and Will Provide Appropriate Incentives for Constructing Needed Transmission.

As described herein, and in the attached testimony, TransConnect’s proposed rates will be just and reasonable and will provide appropriate incentives for constructing needed transmission in the Western United States.

3. Approval of the Application is Supported by the Requisite Cost-Benefit Analysis.

Dr. Patton’s testimony shows that the benefits to consumers of creating an ITC, particularly with the innovative and incentive features proposed by TransConnect in this Application, outweigh the costs by a comfortable margin under generally conservative assumptions.

¹⁴ 95 FERC at 61,338.

G. Commission Rate Filing Requirements

1. Section 35.13(b)(1) – Contents of Filing

The Application begins with a detailed table of contents and list of attachments.

2. Section 35.13(b)(2) – Proposed Effective Date

See discussion in Section II.A of this Application.

3. Section 35.13(b)(3) – List of Persons Served

Appendix 2 of the Application reflects a list of persons served in this proceeding.

4. Section 35.13(b)(4) – Description of the Rate Schedule Change

See discussion in Sections II.B through II.F of this Application.

5. Section 35.13(b)(5) – Reasons for the Rate Schedule Change

See discussion in Sections I.A, I.E, and II.A through II.F of this Application.

6. Section 35.13(b)(6) – Showing of Requisite Agreements

Not applicable.

7. Section 35.13(b)(7) – Costs or expenses that have been alleged or judged to be illegal, duplicative or unnecessary that are the product of discriminatory employment practices.

No statement showing these costs is included since no costs or expenses that have been alleged or judged to be illegal, duplicative, or unnecessary costs that are the product of discriminatory employment practices are included in this filing.

8. Section 35.13(b)(8) – Form of Notice

A form of notice suitable for publication in the Federal Register is attached to this Application as Appendix A and is also provided on computer diskette.

9. Section 35.13(c) – Effect of the Rate Schedule Change

Not applicable. The proposed rates will be TransConnect’s initial rates and do not necessarily reflect the same transmission assets used to derive the prior rates for the members or participants in TransConnect.

10. Order No. 614

TransConnect has not filed a tariff as part of this application. Should it be determined that a separate TransConnect tariff is necessary, TransConnect will file such a tariff consistent with the requirements of Order No. 614.

III. Planning and Expansion Protocol

The April 26 Order found that TransConnect’s proposal to share the planning and expansion function with RTO West was consistent with the requirements of Order No. 2000, but that the Stage I filings lacked sufficient detail and clarity regarding the decisional process for the Commission to evaluate the proposal.¹⁵ Accordingly, the Commission reserved final judgment on TransConnect’s request until a more detailed planning and expansion proposal was filed.¹⁶ Attachment A (Volume II) of this filing is a proposed TransConnect *Pro Forma* Planning and Expansion Protocol (“Planning Protocol”). The Planning Protocol is intended to work in tandem with an RTO Planning and Expansion Protocol to ensure a meaningful and well-coordinated sharing of the planning and expansion function. The Planning Protocol describes the framework and process that will be followed for planning and expanding the

¹⁵ 95 FERC at 61,341.

¹⁶ *Id.*

TransConnect transmission system. The proposal provides that TransConnect will work with the RTO and other applicable regulatory authorities that may have specific “least cost” planning requirements, and will fully comply with any applicable laws or regulations governing such requirements.¹⁷ In sum, the TransConnect planning process is intended to ensure a fair, unbiased and efficient enhancement of the TransConnect transmission system to support robust competition in bulk power markets.

Sharing the planning and expansion function between an RTO and TransConnect creates several important checks and balances, which will improve the overall short and long-term planning and expansion of the transmission system. As a for-profit enterprise, TransConnect will have incentives to find new and creative ways to transport electricity more efficiently across the existing system, as well as to efficiently construct new transmission that is needed and would be economic. If the not-for-profit RTO monopolizes the planning and expansion function, much of this potential for creative solutions will be lost, just as it has been lost under the current cost-of-service regulatory regimes. Thus, TransConnect will check the potential for the RTO to be overly conservative in its planning and expansion function. But because it has final approval authority over specified categories of projects, the

¹⁷ Although TransConnect will work with other entities undertaking least cost planning processes, and will comply with applicable laws, TransConnect itself will not engage in least cost planning. TransConnect will, consistent with its business mission, bring the “wires” option to such processes. Engaging in other aspects of least cost planning could compromise TransConnect’s independence, since least cost solutions may include solutions that can only be undertaken by market participants (such as locally cited generation, or local demand reduction programs).

RTO can restrain planning and expansion that may harm the reliability of the RTO's control area, thus balancing the TransConnect planning and expansion process.

TransConnect has prepared and is submitting this *pro forma* protocol prior to the finalization and submission of the RTO West Planning and Expansion Protocol.

TransConnect believes that the proposed planning and expansion function will provide significant benefits to development of the Western electric grid and that it is appropriate to provide the Commission with this document at as early a stage as possible. TransConnect requests the Commission approve the Planning Protocol as a model that is consistent with the sharing of the planning and expansion function as permitted under Order No. 2000 and in the April 26 Order, and that can be used to establish a final protocol with each of the RTOs (if more than one) within which TransConnect operates.

IV. Compliance Filing

In the April 26 Order, the Commission required TransConnect to: (1) clarify the definition of persons eligible to purchase Class C Common Stock;¹⁸ (2) include a 30-day notification requirement prior to the election by a TransConnect Member to convert its ownership interest to Class C Common Stock;¹⁹ and (3) clarify that the Compliance Auditor

¹⁸ 95 FERC at 61,336.

¹⁹ *Id.*

should also examine the Corporate Manager’s decision making process and should file audit reports, without Corporation approval, within 60 days of their completion.²⁰

The first issue raised by the Commission was caused by an unintentional ambiguity created by the term “Restricted Person” as used in TransConnect’s proposed Articles of Incorporation.²¹ It was not intended that the term Restricted Person would include TransConnect Members who are not market participants. This ambiguity was created in part by failing to modify “any Member of TransConnect,” and in part because there was a missing closing parenthesis in Article VI.B.²² This ambiguity is resolved by modifying the definition in Article VI.B as follows:

. . . no Market Participant (including any Member of TransConnect, LLC, should it be a Market Participant), nor any of its Affiliates (in each such case, a “Restricted Person”)

This change clarifies that Members who are not Restricted Persons may own Class C stock.²³

²⁰ *Id.* The order also noted that the auditor could request a waiver of the time requirement, and may request confidential treatment of reports to the extent they are based on confidential corporate or personal information or data. *Id.* at n.46.

²¹ Attachment D of the October 16 Filing at 3.

²² *Id.*

²³ Members who are not market participants (*i.e.*, who are not Restricted Persons) may also own Class A stock. As explained in TransConnect’s December 5, 2000 Answer to Motions, Protests, and Comments, Class C stock exists to avoid potential tax issues arising from a conversion to Class A stock. Answer at 14-15.

To address the Commission's second concern, Section D of Article VI of the Articles of Incorporation are modified as follows by adding a new paragraph at the end of the section providing for a notification requirement:

Any Member that intends to convert all or part of its Interest in TransConnect LLC to Class C Common Stock shall notify the FERC at least 30 days prior to such election of its intent to convert such Interest. This notification shall include satisfactory evidence that such Member is no longer a Market Participant. Unless the Member is otherwise notified by FERC within the 30-day period, the election may take place following this 30-day period. The notice to FERC is in addition to any other applicable notices or information required under this Certificate of Incorporation.

The changes to the Articles of Incorporation are contained in Attachment B (Volume II), and are shown in redline in Attachment B-1 (Volume II).

To address the Commission's clarifications regarding the role of the independent compliance auditor, TransConnect proposes to modify Article IV, Section 12 of the TransConnect Corporate Manager, Inc. By-Laws by clarifying the scope of the independent compliance auditor and by requiring that the independent compliance auditor file its reports to FERC within 60 days of finalizing such reports, subject to the right of the independent compliance auditor to (a) seek an extension of the 60-day period, and (b) request confidential treatment of such reports to the extent they are based on confidential corporate or personal information or data. The changes to the By-Laws are contained in Attachment C (Volume II), and are shown in redline in Attachment C-1 (Volume II).

V. Modifications to Governance Documents

TransConnect is proposing to modify certain provisions of its LLC Operating Agreement to encourage the participation of additional entities. These modifications are reflected in the modified LLC Operating Agreement contained in Attachment D (Volume II), and are shown in redline in Attachment D-1 (Volume II).

The modified LLC Operating Agreement includes provisions allowing for the participation and investment by non-divesting entities and “public power” entities that are prohibited from owning an equity interest in a for-profit entity.

Entities that do not wish to divest their assets may participate in TransConnect by granting "Functional Control" over their transmission assets pursuant to a Transmission Management Agreement (“TMA”) and thereby becoming a "Participant" of TransConnect. The Form of the Transmission Management Agreement that would be used is included as Attachment E (Volume II). Each TMA will detail the contractual obligations between the applicable transmission owner and TransConnect. The TMA is intended to be sufficiently flexible to accommodate the needs of different types of transmission owners. Each TMA will ensure that TransConnect has been granted sufficient operational or “functional” control over the related transmission assets to permit TransConnect to in turn provide the relevant RTO with the level of control required by the Commission. Although TransConnect will be responsible for filing a Participant’s revenue requirement with the RTO, TransConnect will only include costs associated with the operation of a Participant’s facilities in its own incentive-based rates where it has sufficient operational and cost authority so that such

incentives would be meaningful and would be retained by TransConnect.²⁴ Any such rate filing would be subject to FERC approval.

Under the modified LLC Operating Agreement, non-divesting entities are permitted to make capital contributions to TransConnect, thus becoming "Members" of TransConnect and participating to the extent of their capital contribution in any economic success of TransConnect. (Appendix C provides a numerical example detailing hypothetical working capital and investment allocations.) In recognition of the restrictions on ownership by public power entities, the modified LLC Operating Agreement permits such entities to invest in TransConnect by making loans pursuant to convertible debt in lieu of capital contributions. Such debt may be convertible to an equity interest if the public power entity is later authorized to hold such an interest, or if the public power entity transfers the debt instrument to another party eligible to hold an equity interest. Thus, public power entities are also afforded a means of participating economically in TransConnect.

These revisions to TransConnect's governance documents will provide interested transmission owners, who for business, regulatory, or other reasons may be unable or unwilling to divest their assets to TransConnect at the outset, with a means of significantly participating in TransConnect. Moreover, participation in TransConnect will open to such

²⁴ This will ensure that the price signals associated with the incentive rates will not be sent to a passive Participant, but will be seen directly by TransConnect who will be rewarded (or penalized) according to its performance and ability to manage costs. *See Southern Company Services, Inc.*, 96 FERC ¶ 61,271 at 61-964-65 (2001) (rejecting incentives that would send price signals to passive owners).

entities future investment opportunities in TransConnect, and, subject to the restrictions contained in the TMA and the LLC Operating Agreement, present a set of terms by which they may divest their assets in the future if they so chose.

VI. Communication

Communications and all filings made in connection with this filing should be directed or addressed to:²⁵

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²⁵ Since this is a joint filing, TransConnect requests waiver, to the extent necessary, of 18 C.F.R. 385.203(b)(3), to include the names tendered herein.

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VII. Waivers

TransConnect requests the Commission grant waiver of Section 35.3(a) of its regulations, 18 C.F.R. § 35.3(a) (2001), to permit this filing to be made more than 120 days prior to the proposed effective date of the rate filing. TransConnect also requests any other waivers that may be necessary for the Commission to approve any part of this filing.

VIII. Conclusion

For the reasons stated above and in the attached testimony, TransConnect requests the Commission preliminarily find that the rates and procedures proposed herein, subject to a final compliance filing due 60 days prior to the proposed effective date of TransConnect, are in accord with the Commission's regulations and Order Nos. 2000 and 2000-A.

TransConnect further requests the Commission find that (1) the planning and expansion protocol and compliance portions of this filing are in accord with the April 26 Order, and (2) the proposed modifications to its governance documents, including the new TMA, would not affect the Commission's prior determination that TransConnect would be independent.

Respectfully submitted,

Paul B. Mohler
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Seattle, WA 98104

Attorneys for the TransConnect Applicants

November 13, 2001

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing document (without attachments) upon each person designated on the official service lists in these proceedings in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure.

Dated at Washington, D. C., this 13th day of November, 2001.

Paul B. Mohler
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1666 K Street, NW
Suite 300
Washington, DC 20006-1228
202-912-2153

Appendix A

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

| | | |
|---|---|---------------------------------|
| Avista Corporation; |) | |
| The Montana Power Company;¹ |) | |
| Nevada Power Company; |) | Docket No. RT01-15-_____ |
| Portland General Electric Company; |) | |
| and |) | Docket No. ER02-_____ |
| Sierra Pacific Power Company |) | |
| |) | (Not Consolidated) |
| TransConnect, LLC |) | |

NOTICE OF FILING

Take notice that on November 13, 2001, the above-captioned applicants filed an “Application of TransConnect, LLC For Approval of Transmission Rates, Including Innovative Transmission Rate Treatment; Planning and Expansion Protocol; Compliance Filing; and Modified Governance Proposal” pursuant to Section 205 of the Federal Power Act and Part 35 of the Commission’s regulations. Avista Corporation and The Montana Power Company are joining in only the planning protocol, modified governance, and compliance filing sections of the filing.

TransConnect, LLC requests preliminary approval of transmission rates that reflect the underlying transmission assets that will be transferred to TransConnect, subject to additional approvals that must still be obtained. These rates also reflect innovative and incentive features consistent with Section 35.34(e) of the Commission’s regulations and the Commission’s requirements under Order Nos. 2000 and 2000-A. TransConnect proposes a detailed planning and expansion protocol and has filed modifications to its governance documents to comply with the Commission’s April 26, 2001 order in this proceeding. TransConnect further proposes to modify its governance to provide greater membership flexibility than currently exists.

Any person desiring to be heard or to protest said filing should file a motion to intervene or protest with the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426, in accordance with Rules 211 and 214 of the Commission’s Rules of Practice and Procedures (18 C.F.R. § 385.211 and 18 C.F.R. 385.214). All such motions

or protests should be filed on or before _____, 2001. Protests will be considered by the Commission in determining the appropriate action to be taken, but will not serve to make protestants parties to the proceedings. Any person wishing to become a party must file a motion to intervene. Copies of this filing are on file with the Commission and are available for public inspection. This filing may also be viewed on the Internet at <http://www.ferc.fed.us/online/rims.htm> (call 202-208-2222 for assistance).

David P. Boergers
Secretary

APPENDIX B

Service List

| State Commissions | |
|--|--|
| New Mexico Public Regulation Commission P.O. Box 1269 Santa Fe, NM 87504-1269 Attn: Margaret Caffey-Moquin | New Mexico Public Regulation Commission P.O. Box 1269 Santa Fe, NM 87504-1269 Attn: James C. Martin, General Counsel |
| Oregon Office of Energy 625 Marion Street, N.E. Salem, OR 97310-0001 Attn: Phil Carver | Utah Public Service Commission P.O. Box 45802 Salt Lake City, UT 84145-0802 Attn: Sander J. Mooy |
| Washington Utilities and Transportation P.O. Box 47250 Olympia, WA 98504-7250 Attn: Richard Byers, Analyst | Wyoming Public Service Commission 2515 Warren Avenue, Suite 300 Cheyenne, WY 82002-0001 Attn: Stephen G. Oxley Chief Counsel |
| Wyoming Public Service Commission 123 Capitol Building Cheyenne, WY 82002-0001 Attn: Harry Ivey, Atty. Gen. | California Public Utilities Commission 505 Van Ness Avenue, Room 5035 San Francisco, CA 94102-3214 Attn: Arocles Aguilar, Sean H. Gallagher |
| Montana Public Service Commission 1701 Prospect Ave. P.O. Box 202601 Helena, MT 59620-2601 | Nevada Public Utilities Commission 1150 E William St. Carson City, NV 89701-3109 Attn: Jeff E. Parker General Counsel |
| Utah Public Service Commission P.O. Box 45802 Salt Lake City, UT 84145-0802 Attn: Michael L. Ginsberg | Oregon Public Utility Commission 550 Capitol Street N.E. Suite 215 Salem, Oregon 97301-2551 |
| Customers and Intervenors | |
| Margaret M. Schaff Margaret M Schaff, PC 749 Deer Trail Rd Boulder, CO 80302-9456 | James H. Holt Betts & Holt Suite 1000 1333 H St NW Washington, DC 20005-4707 |
| Vipin Prasad Alberta Power 1800, 700 - 4th Avenue SW Calgory CANADA T2P 3J4 | Randy Stubbings ESBI Alberta Ltd. 736 -8 Avenue SW Suite 900 Calgory, AB CANADA T2P 1H4 |

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| Susan Weber, Chief Counsel California Dept. of Water Resources P.O. Box 942836 Sacramento, CA 94236-0001 | Elisa J. Grammer, Attorney Law Office of GKRSE 1500 K Street, NW, Suite 330 Washington, DC 20005-1209 |
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| | |
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APPENDIX C

Hypothetical Examples for Capitalization Requests under Article III of the Modified LLC Agreement

Utilities A, B and F Contribute Assets (Section 3.4), a 50% Distribution is made on Capital Accounts (Section 6.5) and a \$100 Working Capital Call is funded (Section 3.5)

| | Net Book Value of Net Plant | Asset Value Percentage | Value of Assets Contributed | Equity for Assets Following Expected 50% Distribution | Equity for Working Capital * | Total Equity in Business | Percentage Interest/Investment Percentage ** |
|-----------|-----------------------------------|---------------------------|-----------------------------------|--|------------------------------------|-----------------------------|---|
| Utility A | \$100 | 10% | \$100 | \$50 | \$10 | \$60 | 16.0% |
| Utility B | \$400 | 40% | \$400 | \$200 | \$40 | \$240 | 64.0% |
| Utility C | \$100 | 10% | \$0 | \$0 | \$10 | \$10 | 2.7% |
| Utility D | \$200 | 20% | \$0 | \$0 | \$20 | \$20 | 5.3% |
| Utility E | \$150 | 15% | \$0 | \$0 | \$15 | \$15 | 4.0% |
| Utility F | \$50 | 5% | \$50 | \$25 | \$5 | \$30 | 8.0% |
| Total | \$1,000 | 100% | \$550 | \$275 | \$100 | \$375 | 100.0% |

Investment 1 (Company-Owned Improvement Request)

**\$100.0 System improvement unrelated to any utilities' Transmission Assets
Capital call is based upon Investment Percentage (Section 3.6)**

| | Allocation % | Capital Call | Capital Contribution | New Percentage Interest/ Investment Percentage** |
|-----------|-----------------|-----------------|-------------------------|---|
| Utility A | 16.0% | \$16.0 | \$76 | 16.0% |
| Utility B | 64.0% | \$64.0 | \$304 | 64.0% |
| Utility C | 2.7% | \$2.7 | \$13 | 2.7% |
| Utility D | 5.3% | \$5.3 | \$25 | 5.3% |
| Utility E | 4.0% | \$4.0 | \$19 | 4.0% |
| Utility F | 8.0% | \$8.0 | \$38 | 8.0% |
| | 100.00% | \$100.0 | \$475 | 100.0% |

Investment 2 (Company-Owned Improvement Request)

**\$100.0 Investment in the network of a utility who has contributed assets
Capital call is based upon Investment Percentage (Section 3.6)**

| | Allocation % | Capital Call | Capital Contribution | New Percentage Interest/ Investment Percentage** |
|-----------|-----------------|-----------------|-------------------------|---|
| Utility A | 16.0% | \$16.0 | \$76 | 16.0% |
| Utility B | 64.0% | \$64.0 | \$304 | 64.0% |
| Utility C | 2.7% | \$2.7 | \$13 | 2.7% |
| Utility D | 5.3% | \$5.3 | \$25 | 5.3% |
| Utility E | 4.0% | \$4.0 | \$19 | 4.0% |
| Utility F | 8.0% | \$8.0 | \$38 | 8.0% |
| | 100.00% | \$100.0 | \$475 | 100.0% |

Investment 3 (Participant Territory Improvement Request)

\$100.0 Investment in the network of a utility not contributing assets; assumes it is in Utility C's Service Territory (Utility declines right-of-first refusal); Allocation Method using Asset Value Percentage for Utility C and the remaining requests are allocated on a modified Investment Percentage which excludes Utility C (Section 3.7)

| | Allocation % | Capital Call | Capital Contribution | New Percentage Interest/ Investment Percentage** |
|------------------|--------------|---------------|----------------------|--|
| Utility A | 15% | \$14.8 | \$75 | 15.7% |
| Utility B | 59% | \$59.2 | \$299 | 63.0% |
| Utility C | 10% | \$10.0 | \$20 | 4.2% |
| Utility D | 5% | \$4.9 | \$25 | 5.2% |
| Utility E | 4% | \$3.7 | \$19 | 3.9% |
| Utility F | 7% | \$7.4 | \$37 | 7.9% |
| | 100% | \$100.0 | \$475 | 100.0% |

* Based on each Utility funding its full Asset Value Percentage of the \$100 Working Capital call pursuant to Section 3.5.

** Note that the Percentage Interest and the Investment Percentage only equal in this scenario because there are no Public

Power Participants acting as Debt Holders. Such Debt Holders would have an Investment Percentage but no Percentage Interest in the Company